HOUSING POLICY COUNCIL
THE FINANCIAL SERVICES ROUNDTABLE

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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551

Docket No. R-1417; RIN No. AD 7100-AD75

Dear Ms. Johnson:

The Financial Services Roundtable[1] and its Housing Policy Council[2] (jointly "we") appreciates the opportunity to comment on the proposed changes in Regulation Z relating to standards for complying with the ability to repay requirements in the Dodd Frank Act, including the definition of a Qualified Mortgage (QM).

The Roundtable and HPC are keenly interested in ensuring that consumers have access to affordable mortgage lending, and our comments are designed to ensure that the largest number of consumers who have the ability to repay their loans are eligible to receive a QM. We are concerned that consumers who are unable to qualify for a QM will find it very hard to obtain a mortgage; the supervisory and litigation risks in the statute and rules are so severe that loans that do not satisfy the QM standard will be made only in rare cases.

We believe that the adoption of our recommendations will result in more loans – prudent loans – being made to a wider range of borrowers. Absent the adoption of the recommendations, we fear that the result will be a severe restraint upon mortgage lending, one which will affect all

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[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

[2] The Roundtable's Housing Policy Council is made up of thirty-two companies that are among the nation's leaders in mortgage finance. Member companies originate seventy-five percent of the mortgages for American home buyers and provide mortgage insurance and servicing to the majority of American home owners. Member companies participate in the Council through the senior mortgage executive in their company. Members of the Council are: American Home Mortgage Servicing, Inc., Assurant, Banco Popular, Bank of America Corporation, BB&T Corporation, Citigroup Inc., CoreLogic, Deutsche Bank Securities Inc., Essent Guaranty, Inc., First American Title Insurance Co., Fiserv, GMAC Mortgage, LLC, Genworth Financial, Huntington National Group, JPMorgan Chase & Co., Lender Processing Services, M&T Bank Corporation, MetLife Bank, N.A., MGIC, Nationwide, PMI Group, PNC Financial Services Group, Quicken Loans, Radian, RenaissanceRe / Weather Predict Consulting, Saxon Mortgage, Springleaf Finance, Inc., State Farm Insurance Companies, Stewart Title Company, SunTrust Banks, Inc, US Bank, and Wells Fargo & Company.

segments of society but low- and moderate-income (LMI) and minority borrowers more based on the demographics of the country. We urge the Bureau, therefore, whether it adopts our recommendations, but particularly if it does not, to reconsider the scope and content of these regulations not later than two years after the mandatory compliance date. The impact of these rules will be more visible at that time, and the Bureau can consider then whether adjustments are necessary.

I. Summary of Recommendations

Our recommendations are designed to provide the maximum amount of affordable mortgage lending to consumers in a safe and sound manner within the constraints of the statute and the regulation. To address the finding of Congress that economic stabilization will be enhanced if there is regulation of the terms and practices relating to mortgage credit while ensuring that responsible, affordable mortgage credit remains available to consumers, we recommend that the Bureau modify the proposed rule in the following ways:

Adopt the safe harbor alternative with some modifications.

Add to safe harbor alternative standards requiring consideration of the consumer's employment status and simultaneous loans made by the lender.

Exclude loan officer compensation and affiliate fees, including those for title insurance, from the calculation of points and fees.

Change the definition of smaller loans to those of $100,000 and less.

Clarify the definition of bona fide discount points.

Clarify the rule with respect to construction/permanent loans and loans of limited duration.

Establish in the regulation itself that underwriting standards will be deemed satisfied if they meet widely accepted governmental and non-governmental underwriting standards.

Establish that a loan that fails to meet the standards for the safe harbor is not a Qualified Mortgage.

Establish limitations on right to use certain violations as defenses to foreclosure
Clarify the rule with respect to certain prepayment penalties.

II. General Comments

We support the goal of the Dodd Frank Act to establish more prudent underwriting standards and reduce the risk associated with poorly underwritten mortgages to consumers, lenders, investors, and the government.

Many of the serious lessons of the recent housing downturn already have been incorporated into the underwriting practices of the industry. Loans currently being originated are only of the highest credit quality. Unfortunately, because of the poor economy fewer loans are being made than were made even in the years immediately preceding the recent rapid mortgage credit expansion. In part that is because the underwriting standards are higher, in part it is because lenders and regulators have become more conservative, and in part it is because potential borrowers are without the means to obtain high quality loans. We support the establishment of a well-regulated, less risky residential mortgage market that ensures unscrupulous practices will not return because we believe it is to the nation's long term benefit.

There is, of course, a trade off between prudential lending and quantity of loans made. Prudential lending by definition assumes that some percentage of applicants will not qualify for a loan because of the standards established. For reasons directly related to those standards, some of those who do not qualify will be applicants trying to borrow amounts of funds that exceed the capacity they have to repay loans. Some will be unable to demonstrate that they meet each and every one of the standards established both by the regulatory rules and by guidelines that lenders have established independent of the regulations. Some will fail to obtain loans for other reasons that are instrumental to prudential lending. No documentation loans are gone, and negative amortization and other non-traditional loans have been severely restricted. Many consumers relied upon such loans during the past decade, and in many cases that turned out to be unwise both for consumers, lenders and the economy.

The statute provides severe penalties for violation of the ability to repay provisions.[3] It is the potential of such penalties for even technical violations that creates major uncertainty among participants in the mortgage market.

For example, a lender could have made an appropriate calculation of the ability of a borrower to repay a loan, and made the loan which the borrower in turn faithfully paid for 7 or 8 years. That seems to be ample proof that the borrower had the ability to repay the loan. Yet some life event then occurs in the 9th year (the borrower loses a job, the main income earner dies, there is a divorce in the family, etc.) and the borrower cannot continue to make the monthly payments, regardless of attempts by the servicer to modify the loan. As foreclosure proceedings begin, the borrower's attorney raises the defense of recoupment on the hope that through discovery proceedings the attorney can find some small calculation that violated the regulation. If some such violation is found (such as a miscalculation of the points and fees percentages due to mischaracterization of a fee that is later determined to be a finance charge) the borrower will be permitted the full remedies of the statute. The potential of defending such claims on every loan that goes into foreclosure is daunting.

[3] The statute provides that a consumer who brings a timely action for non-compliance with the ability to repay rule may recover special statutory damages equal to the sum of all finance charges and fees paid by the consumer. This recovery is in addition to actual damages; statutory damages in an individual action or class action; and court costs and attorney fees. In addition, the statute of limitations for an action for violation of ability to repay provisions is 3 years from the date of the occurrence (compared with one year for other TILA violations). Finally, a consumer may assert as a defense by recoupment or set off to foreclosure a violation of Section 129C(a), with no time limit set on the assertion of that defense.

Therefore, lenders will seek certainty. If a lender is unable to clearly identify a QM loan, it is unlikely that the lender will take the risk of making it, nor will many investors purchase it.

The QM test must be straight forward and free of ambiguities. The lender must know upon origination that a loan complies with the QM definition and that a safe harbor will attach to it.

In short, loans for which a clearly delineated safe harbor is not available will not be made in significant numbers. Additionally, the absence of a clearly delineated safe harbor will cause lenders to apply very cautious standards to loan originations; they will not test the limits of the regulation. As a result, some borrowers, including those with blemishes on their credit history, a shortage of assets in their balance sheet or some other mark that prevents them from clearly satisfying the qualified mortgage definition, will not get a loan.

To repeat, our recommendations are designed to maintain the balance between prudential restrictions on lending and the creation of an ample supply of responsible affordable lending to all segments of the population. Since our members believe that Qualified Mortgages will be the only mortgages made (except in rare circumstances), our recommendations are designed to maximize the availability of a robust Qualified Mortgage market in a manner that is consistent with the goals of the legislation and of public policy.

III. Recommendations

a. Adopt the safe harbor option with some modifications.

We believe the Board is correct in concluding that a safe harbor is an appropriate interpretation of the statutory language. The statute defines a Qualified Mortgage in Section 1412 of the Dodd Frank Act (TILA Section 129C(b)(2)) by listing a number of standards that must be met, and then directs the Board to promulgate regulations that implement the purposes of the subsection.

Loans that meet these standards are Qualified Mortgages, and Qualified Mortgages are presumed to meet the ability to repay requirement. (TILA Section 129C(b)(1)). No other criteria need be met. Meeting these standards, therefore, is an alternative to meeting the standards of the general ability to repay sections.

Of course a loan may be challenged even under a safe harbor interpretation, but it cannot be challenged on the basis of its failure to comply with certain more discretionary standards found in the ability to repay provisions. The Board itself recognizes that issue when it says that "Alternative 1 does not define a 'qualified mortgage' to include a requirement to consider the consumer's debt to income ratio or residual income. Because of the discretion inherent in making these calculations, such a requirement would not provide certainty that the loan is a qualified mortgage." (76 Fed. Reg. 27390, 27396). The proposal is correct in concluding that a true safe harbor is needed if lenders are to be encouraged to make residential real estate loans in light of the potential liability created by the Act. The potential liability for originating a loan that later is found by a court to have been made in violation of the ability to repay requirements is substantial and severe, and will cause some lenders to consider directing capital to other sectors of the economy.

> With respect to policy implications, there are sound reasons for interpreting a qualified mortgage as providing either a safe harbor or a presumption of compliance. On the one hand, interpreting a "qualified mortgage" as a safe harbor would provide creditors with an incentive to make qualified mortgages. That is, in exchange for limiting loan fees and features, the creditor's regulatory burden and exposure to liability would be reduced. Consumers may benefit by being provided with mortgage loans that do not have certain risky features of high cost loans. (76 Fed. Reg. 27390, 27453).

Similarly we agree with the Board when it articulates the weakness of not making the safe harbor a true safe harbor:

> The drawback of treating a "qualified mortgage" as providing a presumption of compliance is that it provides little legal certainty for the creditor, and thus little incentive to make a "qualified mortgage," which limits loan fees and features. (76 Fed. Reg. 27390, 27453).

HOEPA contains a similar liability structure to section 1416 of Dodd-Frank, and the result has been that almost no HOEPA loans are made since that law was enacted. We fear that a similar result will occur here – if a loan does not satisfy the QM standard, it likely will not be made.

Loans that meet the ability to repay standards but are not Qualified Mortgages will still be made occasionally by lenders able to portfolio loans. For example, a portfolio lender may still make an interest only loan to a high-net worth individual with whom the institution has a special economic relationship that provides confidence that the borrower can and will repay the loan. Non-QM loans will not, however, be generally available. For lenders whose business model is devoted exclusively to securitization, or to smaller lenders, the options for providing such loans will not make economic sense.

Absent a safe harbor, not only will lenders avoid making loans that violate the standards, most will not make loans that come close to the limitations in the proposal. Unfortunately, this result will directly increase the conservatism of residential mortgage lending even beyond the tight standards in the proposal itself.

In Alternative I (the Safe Harbor alternative), the criteria that must be met for compliance are listed below in italics with a comment on whether the standard is sufficiently delineated that a lender will know whether the loan complies with the standard, and a potential purchaser of that loan in the secondary market can easily ascertain through due diligence whether a loan considered for purchase complies.

- *The loan provides for regular periodic payments that do not result in an increase in principal balance, do not allow the consumer to defer repayment of principal,* *and do not allow for balloon payments.* A lender can feel confident that it can provide sufficient objective facts at the time of origination to conclusively demonstrate that these criteria have been met since these are mathematical calculations.

- *The loan term does not exceed 30 years.* A lender can feel confident that it can provide facts at origination showing that the term of the loan is not greater than 30 years.[4]

- *The total points and fees payable in connection with the loan do not exceed 3% as further defined in the regulation.* While we quarrel with the inclusion of some of the criteria used in the definition of points and fees, we nevertheless believe a lender can feel confident that it can provide facts that will demonstrate that the total points and fees paid in connection with the loan does not exceed 3% of the total loan amount. *(See discussion for increasing the small loan limit, and excluding affiliate fees, loan officer compensation and title insurance from calculation below).*

- The creditor underwrites the loan:
    - *Using a periodic payment of P&I based on the maximum rate that may apply during the first 5 years after consummation.* The lender can feel confident that it can show mathematically that it can meet these requirements;
    - *Using a method in which periodic payments will fully repay either the loan amount over the loan term, or the outstanding principal balance as of the date the interest rate adjusts to the maximum interest rate.* The lender can feel confident that it can show mathematically that the loan meets these criteria.

- *The lender verifies and considers the consumer's current and reasonably expected income or assets and finds them sufficient to repay the loan.* The Commentary provides sufficient guidance for verification and consideration to enable lenders to feel confident that they know they have met this criterion, since use of such objective data as tax records and pay stubs are sufficient verification.

In addition to these standards, Alternative I requires that Qualified Mortgages provide for regular periodic payments that do not result in an increase of the principal balance, allow the consumer to defer repayment of principal (with limited defined exceptions) or result in balloon payments (again, with limited defined exceptions). In other words, loan products that many believe were instrumental in causing many of the excesses during the recent period are excluded from the definition of Qualified Mortgages.

[4] The Bureau should be aware of a widespread industry practice, however, that might technically cause a 30 year mortgage to be slightly longer than 30 years. For example, take a loan that closes on 8/2/11. The first payment on that loan is generally due on 10/1/11 (not 9/2/11 or 9/1/11) which results in the last payment being due on 9/1/41. This is after the 30th anniversary of the closing. We request the Bureau make an appropriate comment on this rule to the effect that such industry practice does not make the loan something other than a 30 year mortgage.

b. Add to safe harbor alternative standards requiring consideration of the consumer's employment status and simultaneous loans made by the lender.

The Bureau may wish to establish additional standards that must be included in order for a loan to qualify as a Qualified Mortgage. If so, HPC believes there are some additional criteria that appear in Alternative II that could be safely added, provided that they were couched in a way that enables lenders to know conclusively at the time the loan is originated whether or not the standards have been met.

The Board proposes in Alternative I that lenders need only comply with the standards listed in TILA Section 129C(b)(2)(A)(i)-(iv) to be in compliance with the ability to repay provisions. That, of course, does not mean that the Bureau could not expand the list of standards with which compliance is required to include additional standards. The Bureau has been given the power to add to the requirements that define a Qualified Mortgage:

> The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion therefore, or to facilitate compliance with such sections. (TILA Section 129C(b)(3)(B)(i)).

If the Bureau is reluctant to provide a safe harbor on the basis of compliance only with the criteria that are listed in Alternative I, then we urge it to expand the criteria that must be met, while retaining a safe harbor where compliance with the expanded list exists. This approach will be consistent with the purposes of the Act and will enable lenders to more freely make responsible, affordable loans available to more consumers.

Lenders review the employment status of an applicant as a matter of course. We believe that it would not be unreasonable to require a lender to determine the employment status of an applicant through easily demonstrable means, such as a payment stub for those who are employees, or tax returns or other documents used for valid third party purposes that demonstrate that the applicant is self-employed. These requirements would not be necessary if the income from employment was not necessary to demonstrate that the applicant could repay the loan. Requiring lenders to consider consumer's employment status could be met with a high degree of certainty.

It may be harder to devise a rigid, easily determinable standard for consideration of simultaneous loans. When the simultaneous loan is made by a lender different from the lender on the "covered transaction," it becomes much more problematic for the lender to know with certainty the terms, conditions and other mortgage related obligations that might be involved in such a loan and therefore the required monthly payments. Certainly if the loan is a HELOC made by a third party, the possible nuances and complexities of the loan is not something that can easily be calculated by the lender in a manner that would permit it to "know" at time of origination of the loan that the loan qualified as a Qualified Mortgage. There are, of course, additional complications in "knowing or having reason to know" that such a loan will be made, let alone knowing or having reason to know the terms and conditions of such a loan.

If simultaneous loans are to be included in the definition of Qualified Mortgage, therefore, they should be limited to those loans that the lender itself makes to the borrower, or loans about which the lender knows. The borrower should be required to certify that such loans do or do not exist, and if the borrower certifies that such a loan exists and provides the terms and conditions of the loan to the borrower, the lender will be expected to consider those terms and conditions.

The Bureau should recognize that there are many state and local governmental programs that provide simultaneous loans to LMI borrowers to assist them in making down payment assistance or closing cost assistance. These programs frequently have components such as zero amortizing payments or interest only payments that do not meet the ability to repay requirements. Yet these loans are essential in many situations to provide the ability for a lender to make the primary loan.

We also believe, on the other hand, that consideration of such elements as the consumer's debt, income and assets do not lend themselves to certain determination of compliance, since such requirements will differ depending on the investor requirements, and therefore requiring lenders to comply with such tests would reduce the use of the safe harbor and hence, restrict lending.

Nevertheless if the Bureau feels that consideration of DTI ratios is necessary to establish a safe harbor, then it should do so cautiously. The Board did not include a requirement to consider the consumer’s debt to income ratio or residual income for the safe harbor option, but did include a requirement to consider the consumer’s debt to income ratio or residual income for the rebuttable presumption option. All of the policy arguments that the Board makes for not including this requirement for the safe harbor option apply with even greater force to rebuttable presumption option. Indeed, if the rebuttable presumption option is chosen and includes a requirement to consider the consumer’s debt to income ratio or residual income, the only certainty available to creditors would be make loans that do not exceed the debt to income ratios specified under the QRM rule (section 941 of Dodd-Frank; 76 Fed. Reg. 24090). This is because under the Dodd-Frank Act the definition of a QRM loan must not be broader than the definition of a QM loan, and therefore the debt to income ratios contained in the QRM rule reflect the collective judgment of the federal regulators that they meet the QM requirements. We believe that this could result in an unnecessary reduction in the availability of credit.

Thus, if consideration of debt to income ratios or residual income is going to be a requirement for a QM loan, it should be in the context of a safe harbor, not a rebuttable presumption, and the Bureau should address the policy concerns raised by the Board directly. There are widely accepted standards for calculating debt to income ratios. We urge the Bureau to establish a DTI ratio that it views as striking the appropriate balance between the consumer’s ability to repay and the availability of credit and provide guidance on how certain aspects of the proposed rule which do not reflect how debt to income ratios are calculated under such standards (such as the interest rate that must be used to qualify an adjustable rate loan) affect such calculations. Similarly, the VA residual income requirements are reasonably objective.

We agree that there is a need for flexibility so that loans may be made to consumers who do not appear to meet either DTI or residual income standards but have the ability to pay due to compensating factors. Yet it remains crucial that making such loans does not create uncertainty on the key question the lender must answer – does the loan it is originating meet the standards for a QM. The Bureau could address this by providing commentary provisions that provide examples of common situations that justify such exceptions, such as (1) the property is an energy-efficient home, (2) the consumer has probability for increased earnings based on education, job training, or length of time in a profession, (3) the consumer has demonstrated ability to carry a higher total debt-load while maintaining a good credit history for at least 12 months, (4) future expenses will be lower, such as child-support payments to cease for child soon to reach age of majority, or (5) the consumer has substantial verified liquid assets.

Expanding the QM standards would address an issue the Board noted in the Supplemental Information – namely, that the standards in the safe harbor provision did not necessarily address the question of the borrower's ability to repay the loan. Absent consideration of some of these additional features, the Board comments, creditors could not be expected to know whether or not the borrower could reasonably be expected to repay the loan. Adding these additional requirements will enhance the underwriting and provide assurances that the loan could be repaid.

c. Exclude loan officer compensation and affiliate fees, including title insurance, from the calculation of points and fees.

The proposed rule imposes a limit on points and fees that can be charged to the borrower of 3% of the total loan amount. Historically, a limitation on points and fees was established because of the concern Congress and the regulators had that lenders could impose unilaterally excessive points and fees on borrowers. Yield spread premiums, loan officer overages, discount points that were not bona fide, excessive charges for administrative services, etc., were all part of the concern, and in many cases, rightly so.

Rather than try to select out individual fees or services and deal with their negative as opposed to beneficial aspects individually, Congress and the regulators chose to simply cap all of the fees, good fees or bad fees, and conclude that fees of an amount less than the cap could be tolerated, but if in excess of the cap, would be deemed to be predatory and subject to severe penalties.

In the Act, and in the proposed rule, a cap still exists. But there is no logical connection between the ability of a particular borrower to repay a loan and the presence of points and fees of more than 3%. Many borrowers could well afford to pay more than 3% points and fees, and still be able to repay a loan containing that level of fees. There is no logical reason for denying a borrower that opportunity by an artificial cap on points and fees in the definition of a Qualified Mortgage.[5]

Against that background, we urge the Bureau to reconsider the general concept of a cap on points and fees as a necessary criterion for determining whether a loan is or is not a Qualified Mortgage. We recognize that the statute is clear – a cap on points and fees should be included, but if the Bureau believes that the general purposes of the statute could be met by modifying that standard, we believe it has the authority to do so on the basis of the exception language in the statute:

> The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary, or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section and section 129B….(TILA Section 129C(b)(3)(B)(i)).

If the Bureau nevertheless decides to retain the points and fees test, we believe there are two criteria in the calculation of points and fees that are not necessary to ensure that the borrower has the ability to repay the loan.

1) *Loan officer compensation*

For example, it is not necessary to include loan officer compensation since the Board has already adopted a regulation that addresses abusive practices associated with loan officer compensation. (12 C.F.R. § 226.36). Including that compensation in the definition of points and fees will not add to the protection that is already embedded in the loan officer compensation rule – that is fixed.

Including loan officer compensation in the current proposal, therefore, is not for the purpose of preventing abusive compensation practices. It may be that the purpose is to prohibit loans in which the total points and fees exceed 3%, notwithstanding that the fees in excess of 3% serve a laudable purpose, and notwithstanding that the borrower chooses to accept the larger fees and has a reasonable purpose for doing so, such as lowering the interest rate on the mortgage. Instead, whatever its purpose, it has as it consequence, intentional or not, that it will serve to reduce the number of loans that can be offered as Qualified Mortgages, and hence, the number of loans that will be offered. The loans that it affects will not be those that are the subject of predatory or abusive loan compensation practices since the earlier rule will have already eliminated that practice.

Not only is loan officer compensation already regulated, there is a risk that the final rule will produce double counting of fees. If a company fits within the definition of a loan originator and is paid a fee for that service, and its employee who also meets the definition of loan

[5] Similarly, many of the practices that led to abuses have now been banned or effectively shorn of their predatory characteristics (some of them since passage of the Dodd Frank Act), including yield spread premium, loan originator overages, and (effectively) non-bona fide discount points.

originator is paid a fee by the company from those proceeds, the literal language of the rule would require that the fees of both be counted in their entirety, even though that then becomes a blatant case of double counting. Only the net amount should be calculated.

That is also the case in the situation in which a broker company receives a fee and pays an individual broker a fee out of those proceeds. Again, only the net amount should be included in the calculation.

The proposal makes it clear that loan originator compensation must be included in the calculation of the points and fees amount proposal; it cannot be avoided. With the cap set at 3% of the total loan amount, a desire on the part of the borrower to buy down the interest rate a bit is all that is needed for the total to exceed 3%. Two bona fide discount points are excluded, but any points above that must be included.

Take what would not be an unusual example: Borrower wants a 30 year fixed, and wants a lower rate than par. He has the ability to pay and is prepared to pay 3 points to get the desirable interest rate (2 B.F. points, so 1 point in P&F calculation). He uses the lender's affiliate title and appraisal services (1 point). The processing fee is one point (1 point). LO comp is one point (1 point).

That is 4 points, so the loan is not a QM and conceivably, as structured, won't be made. That is worth repeating: By adding to the points and fees calculation loan officer compensation, the loan no longer is a QM loan. Yet the borrower had the capacity to buy down the loan rate, and wanted to do so.

One way to avoid that is for the lender to absorb the processing fee, but since there is a cost to processing, that must somehow be included in the revenues the lender receives for originating the loan. Another is to use a non-affiliated title and appraisal company, but there are convenience disadvantages to the borrower to do that. Of course, the borrower could settle for a rate not as low as he wished by paying fewer discount points, but that of course leaves the borrower paying a higher interest rate than he could afford to have paid and was willing to pay.

The unintended consequence of including LO compensation in that calculation, therefore, is to increase the interest rate to the borrower.

It is fair to say that there is a good argument that Congress did not intend to include retail loan officers as loan originators. The Qualified Mortgage exemption is under Section 129C of TILA, but Section 129B of TILA (also added by the Dodd Frank Act) prohibits a mortgage originator from receiving compensation from a person other than the consumer (including the lender) unless the consumer does not make an upfront payment of discount points or origination fees.

It appears that the definition of loan originator in both Sections129B and 129C is the same. If retail loan officers are considered as loan originators, the logical conclusion would be that the lender cannot charge borrowers an origination fee or let the borrower pay discount points to reduce the interest rate if it pays its loan officers. Since it is expected that the lender will pay its own loan officers, the conclusion would be that Congress intended that discount points could no longer be utilized to reduce interest rates, and that lenders could not recoup costs by charging origination fees.

A very unlikely alternative would be that borrowers could pay discount points but would have to pay the individual loan officer directly rather than having that loan officer be paid by the lender.

The better solution is that individual loan officers not be deemed to be loan originators for purposes of Sections 129C and 129B. That decision also would avoid intrusion into the privacy of individual loan officers. Salary and incentive compensation are private, individual matters and the inclusion of a loan officer's entire compensation makes that private information public. Finally it would avoid difficult if not impossible calculations, since the incentive compensation available to the loan officer at time of closing cannot be determined under statutorily permitted systems in which such compensation is based upon a calculation conducted on a periodic basis, not at the time of the origination of each loan.

2) *Affiliate fees, including those for title insurance*

While there is some legislative history to the contrary, it should be understood that including fees to affiliated companies providing services otherwise provided by third parties, but excluding the amounts paid to third parties is on its face restricting lending for no purpose related to ability to repay. Certainly that is true for services such as appraisal s and title insurance. Appraisals are already covered in the appraisal independence provisions of the Dodd-Frank Act which requires that appraisers must be paid reasonable and customary amounts. Title insurance, of course, is largely a state regulated product, and the price that can be charged for it is set by the state, regardless of whether the entity selling the insurance is an affiliate of the lender or not.

There is, then, no purpose in perpetuating a distinction based on whether the services are provided by an affiliate. Appraisal fees are set and monitored through other laws and title insurance fees are set by the state – they are what they are, and are not within the control of the lender. The lender cannot impose predatory pricing through any increase in the cost of appraisals or title insurance. Including those activities, whether conducted by an affiliate, in a standard designed to ensure the borrower has the ability to repay a loan is unnecessary.

The result will be, just as in the case of loan officer compensation to increase the cost to the borrower, or in some cases to move the borrower's loan outside the protection of the QM harbor, and therefore raising serious questions whether or not it will be made at all.

These are examples that illustrate the problem with mandating a hard cap on points and fees as a determinant of whether or not a loan is a Qualified Mortgage.

We urge that the Bureau exercise its authority under the Act to make an exception and subtract loan officer compensation and payments made to affiliated companies providing services such as appraisals or title insurance from the calculation of points and fees.

Finally, we believe that bona fide third party charges that are currently excluded from the finance charge, and therefore would be excluded from the Qualified Mortgage test as it is drafted, would count against the test if the Bureau decides that they should no longer be excluded from the finance charge as the Board has proposed. We would urge the Bureau to exclude these amounts from the Qualified Mortgage test whether it decides to include them in the finance charge. Absent such an exclusion, the number of loans that would qualify as a Qualified Mortgage would drop substantially.

d. Change the definition of smaller loans to $100,000 or less.

We recognize the problems associated with determining an acceptable way of establishing different points and fees tests for smaller loans. Once limitations are established, even on exclusions, there is a possibility that there will be unfair treatment of some loans.

Nevertheless we support the five-tiered first alternative that the Board has proposed, but with a modification in the limit on loans that will be deemed to be "smaller" loans.

Generally accepted industry practice is that a loan of $100,000 - $130,000 and less is deemed to be a "smaller" loan for most of our members. So a selection of $100,000 as the appropriate level for utilizing different points and fees would be reasonable and not inconsistent with hard data collected elsewhere.

Since we feel these figures are not unreasonable, we believe that it is not unreasonable to increase the upper limit of a "smaller loan" to $100,000. Further, we believe that adoption of this standard will increase the numbers of Qualified Mortgages available to the low and moderate income borrowers without jeopardizing the ability of the borrower to repay the loan.

We do not have the data to assist the Bureau in deciding if the gradients in level of points and fees are appropriate, nor data that would suggest that the percentages used are inappropriate at different levels. Nevertheless our reaction to the scale is that the steps between the various loan levels seem appropriate. Of course, if the limit is raised from $75,000 to $100,000 or some higher number, the Bureau would have to change the loan amounts for which various points and fees percentages are allowed. We would recommend that the number of divisions remain the same, but the step levels simply be placed at different dollar amounts to accommodate the movement in the cap to a higher level of loans.

If $100,000 is chosen as the appropriate upper limit on "smaller loans," an alternative series of tiers that would better address the anomaly described by the Board in the Supplemental Information, namely that in some cases a lower loan amount would have greater fees charged than a loan of a higher amount, would be to utilize a schedule such as this:

Loans of $20,000 or less	5%
$20,000 - $40,000	$1,000 plus 4.5% of total loan amount above $20,000
$40,000 - $60,000	$1,900 plus 4% of total loan amount above $40,000
$60,000 - $70,000	$2.700 plus 3% of total loan amount above $60,000
$70,000 - $100,000	$3,000
Over $100,000	3%

e. Clarify definition of bona fide discount points.

The Board has proposed to define bona fide discount points as any percent of the loan amount paid by the consumer that reduces the interest rate applicable to the mortgage loan by an amount based on a calculation that is consistent with industry practices for determining the amount of reduction in the interest rate appropriate for the amount of discount points paid. We do not quarrel with that and believe that is an amount that can be readily demonstrated by the creditor.

However, the Board has also proposed an additional test, namely one that accounts for the amount of compensation that the creditor can reasonably expect to receive from secondary market investors in return for the mortgage loan. That is a much more difficult calculation, as the Board itself admits in the Supplementary Information accompanying the proposal. Not only are there many factors to take into account in trying to reach that determination, but the factors are complex and they interact with each other, each moving based on movements in the others. Proving that the calculation was done correctly will be very difficult at some time in the future when the question is raised whether or not the loan is a Qualified Mortgage.

If the creditor gets it wrong simply because of the difficulty in making the calculation, it is exposed to the severe penalties of the Act. Moreover, the complexity of the calculation does not enhance the validity of the test. The industry practice test is fair and can be easily determined. We urge the Bureau to eliminate the secondary market test as much too susceptible of creating unintentional errors without a corresponding increase in the precision of the definition.

This is consistent with the statutory language that says the types of discount points permitted to be excluded are limited by those for which the amount of the interest rate reduction purchased is "reasonably consistent with established industry norms and practices for secondary market transactions." Utilizing the test proposed by the Board to base the calculation on the industry practices for determining the amount of reduction in interest rate for the corresponding amount of points paid provides a marker that will translate to the practices for secondary market transactions. There is a corresponding relationship between the two that is closely aligned, and that alignment will ensure that the calculation of points for purposes of the points and fees calculation will take into account capital market practices.

f. <u>Clarify the rule with respect to construction/permanent loans and loans of limited duration.</u>

Loans are often made that combine the funds necessary for construction of the property with long-term permanent financing. It is common practice to charge only interest on the amount loaned during the construction phase, and then have traditional residential mortgage financing for the permanent financing. It is also common that those two elements are packaged and closed at the same time, usually as a single loan.

The proposed rule would make it impossible for a loan such as this to be a Qualified Mortgage for a variety of reasons. Not only does the loan have a temporary interest only feature, but it is essential in such a loan that there be higher origination fees, extended lock-in fees and pricing, and a fee for failure of the borrower to convert into the permanent loan. Yet once construction is completed and the conversion occurs, the interest only feature disappears automatically and is replaced by a traditional loan, often a 5/1 ARM with a 30 year term.

Such a loan saves the consumer significant transaction costs by avoiding two closings for two different loans. It also provides the necessary permanent financing in advance of completing the construction, and eliminates concern about the availability and cost of permanent financing after the construction is completed.

We urge the Bureau to use its authority under TILA Section 129C(b)(3)(B)(i) to clarify that loans in which the permanent financing complies with the QM standards, and in which the payments of interest on the construction portion of the loan are consistent with widely accepted practices be deemed to be Qualifying Mortgages. The construction phase could be limited to 24 months as in the RESPA regulations (24 C.F.R. 3500.5(b)(3)).

With respect to other loans of limited duration, those of 12 months or less, the rule states that the scope of the rule applies to any consumer credit transaction that is secured by a dwelling, other than (among other exceptions)

> A temporary or "bridge" loan with a term or 12 months or less, such as a loan to fiancé the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the initial construction of a dwelling. (Proposed Section 226.43(a)(3)(ii)).

This language creates uncertainty, because not only are there undefined terms involved, but there are only two examples among many that could be provided. For example, assume a current dwelling does not sell within a year, or assume that the loan is simply replaced by another 12 month loan under a program that the borrower and the lender agree meets the needs and capacity of the borrower. The exclusion should not be lost for such loans.

We recommend that the Bureau modify the proposal so that the rule reads: "A loan with a term of 12 months or less."

g. Establish in the rule itself that underwriting standards will be deemed satisfied if they meet widely accepted governmental and non-governmental underwriting standards.

The Board in its Staff Interpretations has stated that compliance with various provisions of the rule can be met by complying with widely accepted governmental and non-governmental underwriting standards. We believe these are appropriate general limitations on what would otherwise be vague and ambiguous regulatory standards, causing concern over whether different interpretations would be acceptable to a court or regulator sometime in the future.

While Staff Interpretations carry weight, certainty is crucial. For that reason, we urge the Bureau to incorporate into the regulation itself the provision relating to reliance upon widely-accepted governmental and non-governmental underwriting standards.

h. Establish that a loan that fails to meet the enhanced standards for the safe harbor is not a Qualified Mortgage.

We believe that failure to comply with the rule should be serious. Failure to comply with any of the criteria should negate the protection provided by the rule for any loan. While there is a good argument that the use of compensating factors will enable more worthy applicants to receive reasonable, affordable loans, we believe that widely accepted underwriting standards permit such flexibility. It is not necessary, therefore, for the regulation itself to establish an appropriate matrix that would set parameters in which such flexibility can proceed. The severity of non-compliance will provide assurance that compliance with the safe harbor is a serious and effective supervisory tool.

i. Limitations on the right to use certain violations as defenses to foreclosure.

At the same time, use of such a serious tool for violations that in themselves do not show an inability to repay the loan at time of origination should be discouraged by specific provisions in the regulation.

Many lenders will be wary of lending in an environment in which a solid underwriting decision has been made, a traditional mortgage product has been provided, full and robust disclosures have been given, the borrower has regularly and consistently made the monthly payments in a timely fashion for years, and then, following some unpredictable event, the borrower fails to make payments and as a defense to foreclosure alleges a violation of the ability to repay provisions.

Clearly, if the borrower has made payments for a significant period of time such as 36 months in a fixed rate loan, the facts indicate that the underwriting decision was appropriately made and the lender satisfied the ability to repay requirement. If the violation alleged is not an abusive or deceptive error, but instead is one such as an erroneous but minor calculation of the points and fees percentages, the creditor should be protected from the severe penalties of the Act. Repayment over an appropriate period of time should be ample proof of satisfaction of the ability to repay provisions.

We appreciate that the statute itself is clear – such a defense has been made available to borrowers. Nevertheless, the Bureau has the authority to modify that provision (TILA Section 105(a)), and we urge it to give serious consideration to doing so. The purposes of the ability to repay provisions, stated in TILA Section 129(B)(a)(2), are to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive. The borrower in our hypothetical had the ability to repay at origination, and demonstrated the ability to repay by paying for an extended period of time. A correction of the calculation error on points and fees would not have changed that result.

We recommend that in this and similar situations in which the borrower has demonstrated the ability to repay the loan by in fact repaying the loan for an extended period of time, and the error alleged is not a substantial error directly affecting the ability of the borrower to repay the loan, the borrower should not be able to raise that violation as a defense to foreclosure.

j. Clarification of certain prepayment penalty provisions.

1) *Closing cost recapture*

The Board has proposed changes in the prepayment penalties provisions that we feel should be modified. Proposed Section 226.43(a)(10(I)(B), for example, makes the capture of closing costs advanced a prepayment penalty, and hence will reduce the numbers of loans that will be eligible to be Qualified Mortgages. To avoid that result, lenders could not advance closing costs to borrowers and include them in the amount borrowed if they require those costs be repaid upon prepayment; borrowers would have to bring more cash to the closing.

We agree with the Board that such a requirement should be clearly and fully disclosed as part of the loan documentation and disclosure. Understanding that those advanced closing costs would be subject to repayment is the kind of condition of which the borrower should be apprised at time of origination.

At the same time, however, the repayment of those costs is not a new penalty imposed upon the borrower because of the repayment – it's a collection of funds previously advanced by the lender. Clearly, if there is no prepayment and the lender waives that right to collect the fees, it is an encouragement not to prepay the loan. As such, it should be disclosed, but should not of itself cause that loan to fail to meet the standards of a Qualified Mortgage.

2) *Payments under FHA monthly interest accrual method are not prepayment penalties.*

Under the proposed rule, a prepayment penalty "means a charge imposed for paying all or part of a covered transaction's principal before the date on which the principal is due" and includes a

> charge determined by treating the loan balance as outstanding for a period of time after prepayment in full and applying the interest rate to such 'balance,' even if the charge results from the interest accrual amortization method used for other payments in the transaction.... (76 Fed. Reg. 27390, 27482).

FHA requires use of a monthly interest accrual method. In FHA programs, to allocate a consumer's payment to accrued interest and principal, all loan payments are treated as being made on the scheduled due date as long as the payment is made prior to the end of the grace period. Based on FHA published rules, when an FHA loan is paid off before the end of a month, the borrower must pay interest on the loan from the payoff date until the end of the month. The amount of interest the borrower pays, however, is the same regardless of when he pays the loan and the amount required to be paid cannot be changed by the lender.

Payment under the mandated FHA accrual method, therefore, should not be treated as a penalty imposed by the lender, and hence a fee that must be disclosed on forms that ask whether a prepayment fee is included in the loan. While the FHA itself will determine what is a Qualified Mortgage for its purposes (TILA Section 129C(b)(3)(B)(ii)), the rule adopted by the Bureau will nevertheless define a prepayment penalty for other purposes. Borrowers may be confused by different interpretations, should that be the result. We urge the Bureau to make an exception to the definition of prepayment penalties for payments made pursuant to the FHA monthly interest accrual method.

Recently, the Board of Governors considered this question to remove uncertainty that might otherwise exist. In response to a question from the Department of Housing and Urban Development, it concluded that it concurred with the interpretation by HUD that lenders that use this method "would not be required to treat the interest charged from the date of prepayment until the next installment due date as a prepayment penalty for any purpose under Regulation Z." (Letter from Director Braunstein to Secretary Donovan, dated September 29, 2009).

We believe that the Board was correct in this interpretation and that the Bureau should likewise adopt that interpretation. To ensure clarity, we ask that this interpretation be a part of the Staff Commentary. If the Bureau chooses not to do so, we urge that it defer implementation of that rule until the FHA can modify its rules.

If the Bureau retains this definition of prepayment penalty, we ask the Bureau to work with FHA to ensure that FHA lending is not negatively impacted, and FHA loans are still eligible to be Qualified Mortgages.

IV. Conclusion

The Housing Policy Council has recommended the changes and modifications in the proposed rule in order to provide more prudent residential mortgage lending than would be possible under the proposed rule as drafted. We urge the Bureau to consider carefully the impact of this rule not only on the total loans that are made following its adoption, but also on the segments of the population that are most effected. We believe that the rule as drafted will adversely impact the more vulnerable sector of the population disproportionally.

Regardless of whether or not you accept our recommendations, we believe this regulation if sufficiently significant that you should formally schedule a reconsideration of the rule in the near future, perhaps two years from its effective date.

Thank you very much for offering us an opportunity to comment upon the proposed rule. We are available to answer any questions you may have on the letter. Please contact Paul Leonard at 202-589-1921 or Joan Gregory at 202-589-1923.

With best wishes,

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